STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2004-112

November 5, 2004

MAINE PUBLIC UTILITIES COMMISSION
Investigation into Bangor Hydro-Electric Company's Stranded Cost Revenue Requirements and Rates

RULING ON BHE's MOTION IN LIMINE

WELCH, Chairman; DIAMOND and REISHUS, Commissioners

I. SUMMARY

We deny Bangor Hydro-Electric's (BHE) request for a preliminary order that would exclude any evidence the purpose of which is to support a change to BHE's overall cost of capital used to set stranded cost rates. We will allow such evidence, as well as evidence and argument on whether BHE's stranded costs rate base should earn its properly estimated overall cost of capital or some other rate of return.

II. BACKGROUND

This formal Commission investigation was initiated in February 2004 at the request of BHE to determine whether BHE's then, and still, current stranded costs rates were substantially inaccurate. At that time, BHE forecast severe underearnings in its stranded costs rates during 2004. After conducting discovery and negotiations, a stipulation was filed with the Commission on April 8, 2004, that resolved all issues pending at that time in this docket (2004-112), and all issues raised in Docket No. 2004-5. Docket No. 2004-5 involved a Settlement Agreement between BHE and Penobscot Energy Recovery Company (PERC), that resolved a dispute BHE and PERC concerning the rates paid by BHE to PERC under a Power Purchase Agreement (PPA) between BHE and PERC. The Stipulation called for the Commission (1) to approve the Settlement Agreement; (2) to find that BHE had reasonably mitigated its stranded costs by entering into the Settlement Agreement; and (3) to authorize BHE certain accounting and ratemaking treatment of the financial transactions called for by the Settlement Agreement. The Stipulation also required BHE to stop seeking a stranded cost rate adjustment based upon its February financial forecast, the forecast BHE was relying on in asking the Commission to initiate this docket, 2004-112.

The Commission approved the Stipulation on April 22, 2004. *Bangor Hydro-Electric Company, Request for an Accounting Order, PERC Settlement Agreement,* Docket No. 2004-5, and *Maine Public Utilities Commission, Investigation into BHE's Stranded Cost Revenue Requirement and Rates,* Docket No. 2004-112, Order Approving Stipulation (April 22, 2004). The Stipulation also called for the parties to defer the further processing of this docket until such time as was necessary to establish new stranded costs rates for effect on March 1, 2005.[1]

[1] New stranded costs rates are needed for effect on March 1, 2005, because the current entitlement sale to the output of BHE's not-divested generation assets to

On July 30, 2004, the Examiner issued a Procedural Order that established a litigation schedule for purposes of setting new stranded cost rates for effect by March 1, 2005. Pursuant to that Procedural Order, on October 1, 2004, BHE filed its direct case of its stranded costs revenue requirement and rates. On that same day, BHE filed a Motion *In Limine*, asking the Commission to rule that "any evidence supporting an adjustment to BHE's authorized cost of capital in the Company's last general rate case is inadmissible in this proceeding."

In its Motion, BHE states that the plain language of 35-A M.R.S.A. § 3208(6) does not permit any cost of capital adjustment. BHE asserts that stranded cost proceedings under section 3208(6) are "intended to be limited purpose, so-called single issue, rate cases for the sole purpose of correcting 'any substantial *inaccuracies* in the stranded costs *estimates* associated with *adjustable stranded costs*' or for correcting '*any adjustable stranded costs estimate.*'" (emphasis added in BHE's Motion, at p. 2). In BHE's view, the word "estimates" means only revenue or expenses that can be measured objectively and with certainty in the rate effective period, like the utility's sales volume and the output of a QF generating facility. BHE argues that the utility's cost of capital is not a stranded cost "estimate" within the scope of section 3208(6), because cost of capital is not an "estimated" fact but is merely an informed opinion about investor expectations during the rate effective period. Instead BHE asserts, cost of capital can be fixed only in a general rate case under 35-A M.R.S.A. § 301, as an essential element in setting "just and reasonable" rates at a level that is sufficient to attract that capital on just and reasonable terms. 35-A M.R.S.A. § 301(4).

In BHE's view, a stranded cost proceeding is a single (or limited) issue rate proceeding that, as a disfavored means to set rates, must be conducted as narrowly as possible to accomplish the purposes of section 3208(6). BHE claims that the "closest historical analogue" to a stranded cost proceeding is a fuel adjustment proceeding conducted pursuant to now-repealed 35-A M.R.S.A. § 3101. The Law Court held, according to BHE, that section 3101 needed to be "narrowly interpreted to confine its operation to the special circumstances it was intended to address - the volatility of fuel prices," citing *Central Maine Power Company v. Public Utilities Commission,* 458 A.2d 739 (Me. 1983) and *Maine Public Advocate v. Public Utilities Commission*, 476 A.2d 178 (Me. 1984).

BHE alleges that, like fuel costs, adjustable stranded costs are limited to one aspect of the utility's business (or former business), generation assets. A determination of cost of capital, however, requires an examination of the utility's overall financial conditions, covering all aspects of the utility business. In BHE's view, introducing the overall cost of capital into a stranded cost proceeding impermissibly broadens the proceeding beyond the scope intended by the Legislature.

The Office of the Public Advocate (OPA) and the Industrial Energy Consumer Group (IECG) filed responses to BHE's Motion *In Limine*. The OPA urges the

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Constellation Power Source, Inc. expires on February 28, 2005, and the new sale of that output beginning March 1, 2005, will undoubtedly be for a different price.

Commission to deny BHE's Motion, to permit evidence on the Company's cost of capital to be introduced in this proceeding, and to use a new cost of capital to set stranded cost rates if the Commission is convinced by the evidence that BHE's cost of capital has changed since it was last set in Docket No. 98-596.

The OPA explains that, because of electric restructuring, the Legislature created a special statute to deal with stranded costs, 35-A M.R.S.A. § 3208. Subsection 5 requires the Commission to provide transmission and distribution (T&D) utilities with a reasonable opportunity to recover stranded costs through their rates. To set rates, the Commission is directed to estimate a T&D utility's "adjustable stranded costs" and then correct that estimate for "substantial inaccuracies" at least once every three years. 35 A.M.R.S.A. § 3208(6). The OPA cites the Commission's order in Docket No. 97-596, in which the Commission set BHE's first T&D rates, including stranded costs, and declared the rate setting goal of protecting ratepayers and shareholders from under- or over-recovery of stranded costs. In other words, the OPA concludes, stranded cost rates must adhere to the just and reasonable standard established in 35-A M.R.S.A. § 301. This conclusion is reinforced, according to the OPA, by subsection 5 of section 3208, which requires that the utility be granted no greater or less an "opportunity to recover stranded costs than existed prior to the implementation of retail access."

The OPA points out that BHE's stranded costs include a large number of deferrals, or regulatory assets. These deferrals are referred to as the stranded cost rate base. As with any cost of service rate proceeding, BHE's stranded cost rates are set by first calculating the stranded cost revenue requirement, a component of which involves applying the proper cost of capital to the stranded cost rate base. Because of the large size of its regulatory assets, BHE's return on its rate base component is significant, over $10 million for the next three years, and thus the rate of return is a significant factor in the level of rates.

In the OPA's view, the Commission will not fulfill its obligation under section 301 to set just and reasonable rates, unless the Commission determines BHE's cost of capital for the rate effective period. Therefore, the OPA asserts that the Commission must permit evidence showing that BHE's cost of capital has changed since Docket No. 97-596.

The OPA argues that section 3208's silence about cost of capital does not indicate that the issue may not be considered in a stranded cost proceeding. The OPA points out that section 3208 is also silent about sales forecasts. Yet BHE includes evidence concerning a sales forecast. Forecasts have become an integral part of setting just and reasonable rates. Sales forecasts are used to convert the revenue requirement into rates. Test year or historic sales could be used, but the Commission has decided that forecasts are more likely to produce just and reasonable rates, and thus allows evidence of sales forecasts for the rate-effective period. Similarly, the OPA concludes, section 3208's silence about cost of capital does not preclude evidence about cost of capital, nor the Commission from finding such evidence persuasive in determining just and reasonable stranded cost rates.

The OPA also disagrees with BHE that the concept of single issue ratemaking somehow precludes cost of capital as an issue in this proceeding. Even though the evidence may pertain to the overall cost of capital, and not just to capital costs associated with stranded costs, the cost rate will not be used to change transmission or distribution rates, only stranded cost rates. All elements of stranded costs will (or at least can) be examined. Therefore, the OPA concludes, the prohibition on single issue ratemaking is not implicated.

The OPA also disagrees that fuel clause cases did not include an examination of the proper cost of capital to be used in setting rates. In fact, the OPA asserts, in one of its own fuel clause cases, BHE argued that its short-term debt rate, and not its overall cost of capital, should be used as the carrying cost in the fuel proceeding. Thus, the OPA asserts, fuel clause cases provide support for the conclusion opposite from the one advanced by BHE.

The IECG argues that the plain language of section 3208(6) is also silent on deferrals on non-core, stranded cost revenue amounts, and for carrying costs on such deferrals. Yet, BHE has been authorized to create such deferrals and BHE seeks to recover such deferred regulatory assets, including carrying costs, in its direct case. Using BHE's reasoning from its Motion *In Limine*, the IECG suggests BHE should be denied such recovery.

The IECG concludes that the Commission is not constrained by statute from using a carrying cost different from that set in Docket No. 97-596. Indeed, two stranded cost regulatory assets, Ultrapower and Maine Yankee, receive lower costs of capital than the Docket No. 97-596 overall cost of capital. Therefore, IECG asks the Commission to deny BHE's Motion *In Limine*.

III. DECISION

The issue raised by BHE is one of statutory interpretation. Therefore, it is useful to review the standards for statutory interpretation as decided by the Law Court. In *Darling's v. Ford Motor Company,* 1998 ME 232, ¶ 5, 719 A.2d 111, 114, the Court stated:

> When interpreting a statute, we seek to give effect to the intent of the Legislature by examining the plain meaning of the statutory language and considering the language in the context of the whole statutory scheme. *Estate of Whitter,* 681 A.2d 112, 114 (Me. 1995). We avoid statutory constructions that create absurd, illogical or inconsistent results. *Town of Madison, Dep't of Elec. Works v. Public Utils. Comm'n,* 682 A.2d 231, 234 (Me. 1996).

Section 3208 is the statute at issue. It establishes the requirement that the Commission allow T&D utilities to recover their stranded costs through rates.[2] The

[2] Section 3208(5) provides that "[w]hen retail access begins, the Commission shall provide a transmission and distribution utility a reasonable opportunity to recover

Commission has permitted T&D utilities to recover such costs by setting stranded costs rates using the same cost of service ratemaking approach that the Commission has traditionally used. This traditional cost of service approach means that for one permissible category of stranded costs, utility regulatory assets related to generation (see 35-A M.R.S.A. § 3208(2)(A)), the Commission has estimated not only the cost to amortize the regulatory assets but also the proper rate of return that the unamortized portion of the regulatory asset should earn. Before we address the question of whether section 3208(6) precludes the Commission, when conducting a proceeding pursuant to that section, from changing the rate of return that stranded costs-related regulatory assets will earn, we find it useful to review the whole statutory scheme of which section 3208 is a part, namely the Electric Restructuring Act. 35-A M.R.S.A. §§ 3201-3217.

By the terms of the Act, generation service ceased to be public utility service, and is now provided by competitive electricity providers. 35-A M.R.S.A. § 3202. Electric utilities were transformed into transmission and distribution utilities, and were required to divest some of their generation assets and to sell periodically the output of their generation assets that were not divested. 35-A M.R.S.A. § 3504. Because the divesture and periodic sales were not expected to produce as much revenue as costs, the unrecovered costs were described as "stranded" and were allowed to be recovered in rates charged by the T&D utility. 35-A M.R.S.A. § 3208.

The statutory scheme thus establishes two distinct categories of costs to a T&D utility, stranded costs associated with generation assets and costs associated with investments and expenses incurred to operate a T&D utility. *Id*. In the megacase (Docket No. 97-596), however, because there was no need to do so, transmission, distribution and stranded costs were not unbundled, and BHE's T&D revenue requirement, including its overall cost of capital, was set on a bundled (i.e. not separated) basis. Subsequently, because the Federal Energy Regulatory Commission (FERC) asserted jurisdiction over transmission rates in its Order No. 888, transmission investment and expenses were unbundled from distribution and stranded cost investment and expenses in *Maine Public Utilities Commission*, *Investigation of Retail Electric Transmission Services and Jurisdictional Issue,* Docket No. 99-185 (August 11, 2000). Thereafter, transmission investment and expenses have been recovered through rates set by FERC.

When BHE's stranded cost rates were examined for the first occasion after the megacase, in Docket No. 2001-239, BHE's stranded cost investment and expenses were unbundled from BHE's distribution investment and expenses. Thus, after Docket No. 2001-239, stranded costs rates were separated from distribution rates.

In determining the Docket No. 2001-239 stranded cost revenue requirement, the required return on the stranded cost rate base was set using the overall cost of capital from the megacase. No party raised an issue as the proper rate of return. The Advisory Staff did not raise an issue concerning the proper rate of return in Docket No. 2001-239 because capital costs during the second half of 2001 did not seem to have

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stranded costs through the rates of the transmission and distribution utility, as provided in this section."

changed sufficiently from capital costs in 1999 to warrant testimony and analysis on the issue.

Thus, in the restructured industry, BHE's business is now divided into three separate and distinct sets of rates and accounted for separately for financial purposes: transmission, distribution and stranded costs. Each rate category has its own separated investment and expenses.

As described, distribution rates were initially set as described in the mega-case, Docket No. 97-596, and unbundled from stranded cost rates in Docket No. 2001-239. Subsequently, and pursuant to 35-A M.R.S.A. § 3195, the Commission decided to replace traditional rate of return rate regulation with a price-cap-based incentive rate mechanism for distribution rates. *Bangor Hydro-Electric Company*, Docket No. 2001-410 (June 11, 2002). Thus, since 2003, distribution rate changes have been made annually based upon an inflation index minus productivity factor formula, with no need to recalculate BHE's overall cost of capital. Under its Alternative Rate Plan, the required return for BHE's distribution investment is not a relevant regulatory issue.

As to transmission investment, FERC now has responsibility for determining the proper rate on investment. Indeed, in the 2003 BHE transmission rate case at FERC, the parties agreed to an increase in BHE's transmission cost of capital. *Bangor Hydro-Electric Company,* FERC docket No. ER00-980-007 (2003). Thus, on transmission investment, BHE now earns a return greater than the overall cost of capital set by the Maine Commission in the megacase.

This proceeding is the second occasion to re-set BHE's stranded costs rates since the mega-case. The statutory authority and direction for stranded cost recovery through rates is set forth in section 3208. Our review of that statute, when examining the plain meaning of the language and considering the language in the context of the whole statutory scheme, causes us to agree with the OPA's statutory interpretation and not BHE's.

Subsections (2)(A) and (6) of section 3208 operate to define BHE's regulatory assets associated with generation assets to be "adjustable stranded costs." Indeed, regulatory assets constitute the largest category of BHE's estimated stranded costs beginning in March 2005. We believe a "plain reading' of subsection 6, in the context of the entire statutory scheme, means that a necessary component of adjustable stranded costs includes the return on an unamortized regulatory asset, and that the return that should be earned on that regulatory asset is a "stranded cost estimate" that may have become substantially inaccurate either because the wrong return was used (e.g. overall cost of capital vs. short-term debt cost) or its calculation is out-dated. We do not agree with BHE that the "plain meaning" of "estimate" excludes rate of return.

Even if we accept that there is some ambiguity about whether "estimate" could include rate of return, as the OPA correctly argues, subsection 5 helps to resolve any ambiguity in subsection 6. Subsection 5 provides that: "Nothing in this chapter may be construed to give a transmission and distribution utility a greater or lesser opportunity to recover stranded costs than existed prior to the implementation of retail access." It

would appear that the statutory interpretaton sought by BHE in its Motion would give it a greater or lesser opportunity to recover costs compared to before retail access depending on how the current cost of capital compared to the previous cost of capital. BHE seems to argue that its unamortized regulatory assets (other than Ultra Power and Maine Yankee) must receive a return based on its overall cost of capital, which can never be recalculated until its ARP expires and a combined distribution and stranded costs rate case can be conducted. Prior to retail access, the rate of return was not set in stone while the regulatory asset was subject to cost of service rather than incentive regulation.[3]

We reject BHE's characterization of stranded costs proceedings as intended to be limited purpose or so-called single-issue rate cases. Ratemaking for BHE now is divided in three distinct segments. A transmission rate case at FERC is not a single issue proceeding, even though BHE's transmission revenue requirement is considerably smaller than its stranded costs revenue requirement. A stranded cost proceeding is similarly not limited in any way since all generation-related costs and investments can and have been examined.

While the plain reading, in the context of whole statutory scheme, does not lead us to conclude that evidence on the proper rate of return to apply to amortized regulatory asset balances is precluded by section 3208(6), BHE or any other party is free to argue that the overall cost of capital, of its total distribution, transmission and stranded cost portions of its business, is not the proper return to apply to its stranded cost rate base. By the same token, the parties are free to argue that BHE's stranded costs related investments were not separately financed from its transmission and distribution investments, and traditional ratemaking theory does not allow for the tracing of funds from source to use. Therefore, they could argue that the utility's overall cost of capital should be used to compute the return on stranded cost rate base. However, we reject BHE's argument that the Commission must apply BHE's overall cost of capital (to its stranded cost rate base), as computed about five years earlier, or that the currently used rate cannot be re-examined here because the Commission must conduct a distribution cost rate case to do so.

We also agree with the OPA that the fuel cost cases do not support BHE's position. Chapter 34, the rule by which the Commission implemented the fuel cost adjustment statute, initially used the utility's short-term debt rate as the carrying cost for the over/under collections. Then in 1982, the Commission amended the rule and

[3] As pointed out by the IECG, the plain language of subsection 6 does not describe the ratemaking treatment that has been afforded to this category of stranded costs (and is sought again by BHE in its Direct Case), namely, the amortization of the regulatory asset and a return on the amortized balance. We do not agree, however, with any implication that the failure to mention a rate of return in subsection 6 precludes the utility from receiving one as part of its adjustable stranded costs.

employed the overall cost of capital as set in the utility's most recent base rate case.[4] *Proposed Amendments to Chapter 34, Statement of Factual and Policy Basis and Order Adopting Rule,* Docket No. 82-55 (June 21, 1982). In 1986, the Commission returned to using a short-term debt rate as the carrying cost for fuel balances. *Order Adopting Rule and Statement of Factual and Policy Basis (Proposed Amendment to Chapter 34),* Docket 86-113 (Sept. 16, 1986).

Contrary to BHE's assertions, fuel clause cases did not preclude evidence on carrying costs because such cases were "single issue" proceedings that prohibited evidence on carrying costs. Rather, evidence was precluded because carrying costs were defined in the rule. Thus, even accepting fuel clause cases as "limited issue" proceedings, carrying costs were seen as an essential element of fuel clause ratemaking.[5]

Accordingly, we deny BHE's Motion *in Limine.*

Dated at Augusta, Maine, this 5th day of November, 2004.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Diamond
Reishus

[4] The Commission rejected the notion of recomputing the utility's fair rate of return in each fuel case as unnecessarily expanding the scope of a fuel cost case. Id at 5. Fuel clause cases were required to be filed every nine months, and could be filed as frequently as every 90 days at the time.

[5] Carrying costs, however, were never a controversial issue, because the rule precisely defined how carrying costs would be calculated.

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.